BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
EDGAR A. AND BARBARA A. GOLDEN)

Appearances:

For Appellants: Robert W. Wright
Certified Public Accountant

For Respondent: Claudia K. Land
Counsel

O P I N I O N

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Edgar A. and Barbara A. Golden against proposed assessments of additional personal income tax in the amounts of $1,067.74, $1,101.65 and $888.86 for the years 1973, 1974 and 1975, respectively.

The sole issue for determination is whether the payments involved are properly characterized as distributions of corporate earnings and taxable to appellants as dividends, or whether they were made subject to bona fide loan transactions between appellants and the corporation.

Appellants are the sole shareholders of Golden's Magic Wand (GMW) which sells jokes, games, gag items and novelty gifts by mail order. During each of the appeal years, GMW -paid some of appellants' personal expenses, such as property taxes on their residence and federal and state income taxes. These payments, amounting to a total of $12,122, $10,015 and $8,082 in 1973, 1974 and 1975, respectively, were not identified as loans or as repayments of loans on the corporate books, nor were they reported or deducted as expenses on GMW's franchise tax returns. GMW's financial records indicate that it retained earnings of $91,512 in 1973 and 1974, and $88,213 in 1975. Liabilities shown on its balance sheet for those years included $13,656 identified as "loans from shareholders." The corporation has never declared a dividend.

Under these circumstances, respondent determined that GMW's payments of appellants' personal expenses were constructive dividends. Since appellants had not reported them as income, respondent issued notices of proposed assessment. On protest, respondent reaffirmed its proposed assessments. It is from this action that appellants appeal.

Whether a withdrawal of corporate funds by a shareholder represents a taxable dividend or a nontaxable loan is a question of fact which must be resolved in the light of all the facts and circumstances surrounding the transaction. (Berthold v. Commissioner, 404 F.2d 119 (6th Cir. 1968); Elliott J. Roschuni, 29 T.C. 1193 (1958), affd. per curiam, 271 F.2d 267 (5th Cir. 1959), cert. den., 362 U.S. 988 [4 L. Ed. 2d 1021] (1960); Appeal of Robert B. and Joanna C. Radnitz, Cal. St. Bd. of Equal., May 6, 1971.) The controlling or ultimate determination in a particular case is whether, at the time of the withdrawal, the parties in interest genuinely intended that the funds be repaid. (Estate of Taschler v. United States, 440 F.2d 72 (3rd Cir. 1971); Atlanta Biltmore Hotel Corp., ¶ 63,255 P-H Memo. T.C. (1963), affd., 349 F.2d 677 (5th Cir. 1965); Appeal of Jack A. and Norma E. Dole, Cal. St. Bd. of Equal., Nov. 6, 1970.) However, with respect to a shareholder who withdraws funds from his wholly owned corporation, the objective manifestations of the parties'

intent must be viewed with special scrutiny. (Elliott J. Roschuni, supra, 29 T.C. at 1201; Harry Hoffman, ¶ 67,158 P-H Memo. T.C. (1967).)

Appellants argue that the corporation's payments of their personal expenses represented repayment of a $14,000 note executed by GMW in appellants' favor at the time of incorporation. Payments in excess of this amount are claimed to have been loans to the shareholders which were repaid in 1976 when appellants lent $49,000 to GMW.

In support of their contention, appellants cite the case of Taft v. Commissioner, 11 Am. Fed. Tax R.2d 1031 (1963). In Taft, the corporation had executed a promissory note in the amount of $106,931.82 in 1954 to its majority shareholder which was entirely repaid over the years 1954 to 1959. The first dividend was paid by the corporation in 1959. We must agree with respondent, however, that the facts in Taft render it readily distinguishable from the instant appeal. In Taft, the court noted certain factors in concluding that the payments should be classified as loans, such as: (1) the notes represented long term indebtedness; (2) the obligation of the corporation to pay was positive and unconditional; and (3) as payments were made, the indebtedness was reduced in the corporate books. In other words, all of the formal indicia of indebtedness were observed in Taft, and such factors are not present here.

In a matter quite similar to the instant appeal, this board determined that certain withdrawals were taxable dividends and not loans. (Appeal of Albert R. and Belle Bercovich, Cal. St. Bd. of Equal., March 25, 1968; see also Lou Levy, 30 T.C. 1315, 1327 (1958).) The Bercovich case revealed a steady pattern of withdrawals by appellant from his family owned corporation. The withdrawals were entirely for appellants' personal use. No debt instruments were ever executed and no interest was ever paid. Additionally, like the present case, the corporation had not paid a formal dividend for years.

The facts in the Appeal of Joel Hellman, decided by this board February 2, 1976, are even closer to the instant appeal. In Hellman, appellant, as well as his wife and son; had made loans to the corporation, which appellant proposed should be offset against his withdrawal. In deciding that the payments should be characterized as dividends, this board emphasized that no rule exists which forbids the treatment of corporate distributions as dividends merely because the stockholder may also be a creditor of the corporation.

We note appellants' mention of the fact that during the years on appeal, they had not availed themselves of the professional assistance of either an attorney or an accountant. Previously, from its incorporation until 1970 or 1971, GMW had retained an attorney who prepared the corporate minutes and who identified payments similar to these now in dispute as bonuses. Appellants contend that had payments during appeal years been intended as bonuses, they would have been so identified. We cannot agree. Appellants cannot, by their act of omission regarding the minutes, create the self-serving inference that the payments in question should be classified as loans. It is equally inferable that the intent was that the pattern established during the pre-appeal years be continued which would characterize the payments as bonuses, and therefore taxable as income. Both inferences are unduly speculative. It is regrettable that appellants chose not to avail themselves of the benefit of professional assistance during the appeal period; however, this does not alter the fact that they had the burden of establishing the characterization of the payments in question.

Since appellant has failed to establish that the payments in question were loans, we must sustain respondent's characterization of them as taxable distributions.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

Appeal of Edgar A. and Barbara A. Golden

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Edgar A. and Barbara A. Golden against proposed assessments of additional personal income tax in the amounts of $1,067.74, $1,101.65 and $888.86 for the years 1973, 1974 and 1975, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 30th day of June, 1980, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member